DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS: 03-0408
Indiana Corporate Income Tax
For Taxpayer's First Short Tax Period of 1997

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ISSUE

I. **Combined Income Tax Return** – Adjusted Gross Income Tax.

Authority: IC 6-3-2-2(l); IC 6-3-2-2(m); IC 6-8.1-5-1(b).

Taxpayer argues that the Department of Revenue erred in requiring taxpayer – as parent company – to submit a combined income tax return reporting its own income and the income of five related business entities.

STATEMENT OF FACTS

Taxpayer is the out-of-state parent company of a group of subsidiaries which operate fast food restaurants throughout the United States including locations within Indiana. During 2003, the Department of Revenue (Department) conducted an audit review of taxpayer's business records.

Taxpayer owned and managed restaurants located in Indiana and filed income tax returns for the period at issue. However, after conducting the audit review, the Department determined that taxpayer should have been filing a combined return reporting taxpayer's own Indiana income along with the income of five of taxpayer's subsidiaries.

The Department's adjustment resulted in an assessment of additional corporate income tax. Taxpayer disagreed with the Department's reporting methodology and submitted a protest to that effect. An administrative hearing was conducted during which taxpayer further explained the basis for the protest. This Letter of Findings results.

DISCUSSION

I. **Combined Income Tax Return** – Adjusted Gross Income Tax.

During the audit review of taxpayer's state income tax returns, the Department concluded that taxpayer should have been filing a combined return reflecting taxpayer's own income and that of its subsidiaries. The audit report indicated that the combined reporting method was necessary "due to the substantial intercompany activities between the group" and "to fairly reflect the income earned from Indiana sources." Specifically, the audit determined that taxpayer should have been filing a combined return reporting its own income along with that of five different related entities. One of these five entities is a “royalty” company which holds title to the intellectual property used to identify and market the group’s numerous fast food restaurants. The remaining four entities own restaurants or groups of restaurants in states other than Indiana. In all cases, taxpayer maintains that the five entities do not have nexus with the state.

Taxpayer disagrees with the decision requiring the combined reporting. Specifically, taxpayer argues that taxpayer’s original “Indiana corporate income tax return as filed fairly represents [taxpayer’s] Indiana income.” In addition, taxpayer argues that the filing of the combined return “would lead to a greater distortion of income.”

IC 6-3-2-2(m) provides as follows:

> In the case of two (2) or more organizations, trades, or businesses owned or controlled directly or indirectly by the same interest, the department shall distribute, apportion, or allocate the income derived from sources within the state of Indiana between and among those organizations, trades, or businesses in order to fairly reflect and report the income derived from sources within the state of Indiana by various taxpayers.

In addition, IC 6-3-2-2(l) vests both taxpayers and the Department with authority to allocate and apportion a taxpayer’s income within and among the members of a unitary group of related entities.

> If the allocation and apportionment provisions of this article do not fairly represent the taxpayer’s income derived from sources within the state of Indiana, the taxpayer may petition for or the department may require, in respect to all or any part of the taxpayer’s business activity, if reasonable;
>
> > (1) separate accounting;
> >
> > (2) the exclusion of any one (1) or more of the factors;
> >
> > (3) the inclusion of one (1) or more additional factors which will fairly represent the taxpayer’s income derived from sources within the state of Indiana; or
> >
> > (4) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer’s income.

It is apparent from the language contained with IC 6-3-2-2(l) that the standard apportionment filing method is the preferred method of representing a taxpayer’s income derived from Indiana sources. The alternate methods of allocation and apportionment – including the combined reporting method – are only employed when the standard apportionment formula does not fairly reflect the taxpayer’s Indiana income.

Taxpayer concludes that it correctly filed a state tax return reporting only its own Indiana income; the audit concluded that a combined return was the only accurate way to report taxpayer’s Indiana income. Taxpayer states that the original return “fairly represents [taxpayer’s] Indiana income; the audit report states that only a combined return “fairly reflect[s] the income earned from Indiana sources.”

Taxpayer and its various subsidiaries own and operate restaurant chains throughout the United States and Indiana. A certain amount of the income produced by the Indiana restaurants is paid directly one of taxpayer’s subsidiaries because the subsidiary purportedly holds title to the intellectual property associated with the Indiana restaurants. That intellectual property was licensed for use within the state. In a separate Letter of Findings, the Department concluded the royalty subsidiary had established an Indiana nexus because licensing the royalty subsidiary’s intellectual property to Indiana franchisees produced royalty income subject to the Indiana corporate income tax.

IC 6-8.1-5-1(b) provides that, “The notice of proposed assessment is prima facie evidence that the department’s claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the assessment is wrong.” Given the relationship between taxpayer and the various subsidiaries, the diversion of royalty income obtained from operating the Indiana restaurant chains, and the “substantial intercompany activities between the group,” the Department agrees with the audit’s conclusion that taxpayer and its subsidiaries should have been filing a combined return in effort to “more fairly” reflect the group’s Indiana income.

Pursuant to IC 6-8.1-5-1(b), taxpayer has failed to meet its burden of rebutting the presumption that the original audit decision was correct. Taxpayer has failed to demonstrate that combined filing requirement would distort the amount of income taxpayer received from conducting business within this state.

FINDING

Taxpayer’s protest is respectfully denied.

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